MORTGAGE TERMINOLOGY 101

For new home buyers, mortgages are a necessary part of purchasing their dream home. With so many unique and challenging terms, it can be difficult to fully understand everything included in a new home buyers mortgage agreement. Below is the terminology you need to know before you sign your mortgage agreement. Understanding all of the important terminology associated with your mortgage will help you choose the mortgage product that meets your financial needs and is right for you.

Mortgage
A mortgage is a personal loan used to purchase a property. As a homebuyer, you pledge your property to the lender as security for your loan. The mortgage amount is the difference between the home's purchase price and the buyer's down payment

Down Payment
The down payment is the amount of money the buyer is initially investing in the property. This is the difference between the purchase price of the home, and the value of the mortgage payment.

Principal
The principal is the amount of money borrowed from the lender your mortgage. If you are already paying a mortgage, it is the amount remaining on your mortgage.

Mortgage Payments
The mortgage payment is the periodic payments made from the buyer to the lender to pay for the mortgage. These payments are usually made monthly, bi-weekly or weekly towards the principal and the interest added to your mortgage.

Interest Rate
The Interest rate on a mortgage is a percentage of the principal charged by the lender for using their money to purchase your home. In Canada, this rate is compounded semi-annually, or twice per year. Interest is paid in addition to the mortgage payments.

Term
Mortgage term is the number of months or years that the mortgage agreement covers. During this time, you pay a fixed interest rate. When the term expires, a buyer has to either pay the outstanding mortgage balance, or negotiate a new term.

Amortization
The amortization period is the length of time it will take to fully pay off your mortgage. This is usually longer than the actual mortgage term. The most common length of amortization is 25 years. The most important thing to keep in mind with the amortization period is that the longer the amortization of your mortgage, the more interest you will have to pay.

Equity
The equity of your home is the value of your home beyond the amount owed. In other words, your equity is the difference between the price that your home could be sold for, and the amount owing on your new home.

Loan-To-Value Ratio (LTV Ratio)
The LTV ratio is the mortgage loan amount compared to the total purchase price represented as a percentage. For example, if someone purchased a home for $200,000 and put a down payment of $50,000 towards the home, they would need a mortgage of $150,000. This $150,000 is 75% of the purchase price of the home and therefore, the LTV ratio is 75%.

Prepayment Penalties
When you agree to a mortgage and amortization period, you lock yourself in to that exact schedule. A prepayment penalty occurs when you pay your mortgage off early. This penalty is usually the equivalent of three months interest payments.

Prepayment Penalties
Stress testing is a best practice for mortgage lenders. It involves considering extreme "what-if" scenarios to ensure buyers are prepared for them. In Canada, the new stress test requires that borrowers qualify at the higher figure between the five-year benchmark rate or two percent above the contracted mortgage rate.

Understanding the details of a mortgage can be one of the most challenging parts of purchasing your new home. There are so many small details and unique terms that it is common to not be completely aware of what your mortgage means for you. By understanding the terms above, you will be equipped to ask the right questions, and have the appropriate understanding of what to look for when you are reviewing mortgage lenders.